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United States

Circuit Court of Appeals,

FOR THE NINTH CIRCUIT.

Wm. H. Moore, Jr., *Appellee,* *vs.* National Bank of Bakersfield, et al., *Appellants.*	A 32.
Wm. H. Moore, Jr., *Appellee,* *vs.* National Bank of Bakersfield, *Appellant.*	B 94.

BRIEF OF APPELLANTS.

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BRIEF OF APPELLANTS.

STATEMENT OF THE CASE.

The above entitled causes, two in number (A 32 and B 94), were tried together, are presented on appeal by a joint transcript, and are to be considered in a single set of briefs.

A 32.

In A 32 the Trustee of Alfred W. Bannister, bankrupt, seeks to set aside, as being a preference, a trust

deed in favor of certain trustees, executed by said Bannister April 8, 1915, recorded April 23, 1915, and given as security for Bannister's pre-existing indebtedness to the defendant Bank. The involuntary petition in bankruptcy against Bannister was filed May 5, 1915; and the order of adjudication was made May 24, 1915, on Bannister's default. Of the issues framed by the pleadings the following, since they are the subject of consideration hereinafter, should be particularly noted, to-wit:

First: Will the enforcement of said transfer operate to give other creditors of said bankrupt, having allowed claims against the bankrupt estate, a lesser percentage of their debt than said defendant will receive by reason of such transfer?

Second: Did the defendant Bank, at the time of the execution, or at the time of the recordation, of said trust deed, have reasonable cause to believe that such transfer would operate to effect a preference in its favor over the other creditors of said grantor of the same class as said defendant?

B 94.

In B 94 the Trustee seeks to set aside, as being preferences, four chattel mortgages executed and delivered by Bannister to the defendant Bank on the dates, and covering property, respectively as follows, to-wit: December 21, 1914, covering a removable corrugated iron and frame warehouse building on leased grounds at Wyble Siding, Kern county; January 5, 1915, covering a Stutz automobile; January 12, 1915,

covering certain hay and grain particularly described therein; January 12, 1915, covering certain grain hay particularly described therein;— all of which were recorded April 23, 1915; also to have declared preferential certain payments made by Bannister to defendant subsequent to January 4, 1915. The answer denies most of the material allegations of the bill except the jurisdictional facts, and further alleges facts which defendant contends establish an equitable lien upon the mortgaged property in favor of defendant superior to any claim of the Trustee thereto. The answer alleges that, in addition to the chattel mortgages mentioned in the bill, Bannister executed and delivered to defendant other chattel mortgages on the following dates, to-wit: November 11, 1914; December 1, 1914; December 9, 1914; December 21, 1914; January 4, 1915; January 5, 1915; none of which were ever recorded; and which mortgages covered certain specified hay and grain which in the aggregate comprised all the hay and grain described in the "blanket" mortgage of January 12, 1915, mentioned in the bill as Exhibit "A" thereto; that, at the time each of said mortgages was received by defendant, Bannister received from it a loan for the purpose of purchasing certain hay or grain, in consideration of which he executed and delivered to defendant promissory notes evidencing said loans, respectively, and said chattel mortgages securing said notes, respectively, and covering the property to be purchased with the proceeds of said loans; and in each instance agreed to, and thereafter did, remove said property to his Bakers-

field warehouse, and thereupon, on January 12, 1915, executed and delivered to defendant said "blanket" mortgage. On April 23, 1915, defendant recorded the four mortgages referred to in the bill, and thereupon occurred the acts which defendant contended at the trial constituted a taking of possession by it of the mortgaged property. On May 5, 1915, the petition in bankruptcy was filed against Bannister, and between April 23rd and June 24th, 1915, the defendant disposed of the mortgaged property for the net sum of $9381.13, which it applied upon Bannister's indebtedness, $1000.00 of which sum was received by it between April 23rd and May 5th.

Numerous issues are raised by the pleadings, but those considered hereinafter are specified in the following

SPECIFICATION OF THE ERRORS RELIED UPON.

A 32.

The trial court erred:

1. In denying defendants' motion to dismiss the bill, made at the close of plaintiff's case, in that:

(a) It was not shown that the enforcement of the transfer in question would operate to the injury of other creditors of Bannister having allowed claims against the bankrupt estate;

(b) Defendant Bank was not shown to have had "reasonable cause to believe" said trust deed would operate to effect a preference in its favor.

2. In decreeing that said trust deed constituted a preference within the meaning of the United States

Bankruptcy Act, and in declaring said trust deed null and void, in that:

(a) It was not shown that the enforcement of said transfer would operate to the injury of other creditors of Bannister having allowed claims against the bankrupt estate;

(b) Defendant Bank was not shown to have had on either of said dates "reasonable cause to believe" such transfer would operate to effect a preference in its favor.

B 94.

The trial court erred:

1. In denying defendant's motion to dismiss the bill, made at the close of plaintiff's case, in that:

(a) It was not shown that the enforcement of any of the transfers or payments in question would operate to the injury of other creditors of Bannister having allowed claims against the bankrupt estate;

(b) It was not shown that the plaintiff represented creditors as to whom the chattel mortgages in question were void.

2. In decreeing the chattel mortgage of December 21, 1914, covering the corrugated iron and frame warehouse at Wyble Siding, and that of January 5, 1915, covering the Stutz automobile, to be null and void and of no effect.

3. In decreeing the chattel mortgages of January 12, 1915, null and void as to plaintiff, and in holding defendant did not have an equitable lien upon the property covered by the chattel mortgages set forth in the

bill, and the answer thereto, by reason of the transactions by which said mortgages were respectively received by defendant.

4. In overruling defendant's objections to the amendment to the bill herein, taken by way of answer thereto, on account of the insufficiency of its allegation of fact and the uncertainty thereof.

5. In receiving, over the objection of defendant, testimony in support of the allegations of said amendment to the bill herein, which evidence, in substance, was the testimony of Bannister to the effect that on certain dates, not specified in the amendment, he incurred certain indebtedness, the amounts of which items and the names of which creditors and the proof of which claims against the bankrupt estate are not alleged in said amendment.

6. In decreeing, in spite of the errors assigned, that defendant pay plaintiff the sum of $9381.13, with legal interest from July 10, 1915.

BRIEF OF THE ARGUMENT.

I.

A Deficiency of Assets of the Bankrupt Estate to Satisfy Proven Claims Not Shown.

An error common to, and which should be decisive of, both appeals was the action of the trial court in denying in both cases the motions of the defendants to dismiss the bills therein; also in permitting any recovery in either case; for it was not shown that the enforcement of any of the transfers in question in either

case would operate to the injury of any other creditor of Bannister having a proven claim against the bankrupt estate.

It is well settled that the Trustee, in order successfully to maintain either of these actions, must sustain the burden of showing that the enforcement of the alleged preferences he seeks to avoid will result in other creditors of the bankrupt whom he represents, of the same class as defendant, receiving a lesser percentage of their claim than the defendant Bank will receive by reason of the alleged preferences (1 Remington on Bankruptcy, par. 1768, Supp., par. 1403½).

> Tumlin v. Bryan, 165 Fed. 166:
>
> "The burden of proof is on the complainant, and, unless he shows by sufficient evidence the elements of a voidable preference, he is not entitled to recover. He must prove that * * * 4th. The creditor receiving the payment was thereby enabled to obtain a greater percentage of his debt than other creditors of the same class."
>
> 165 Fed. 167.

The trustee represents only those creditors who have proven their claims against the bankrupt estate in the manner provided and required by the bankruptcy law.

> Leavengood v. McGee, 91 Pac. 453, 50 Ore. 233:
>
> "But a method is provided by the procedure in bankruptcy whereby the claims of creditors may be legally adjudicated, and before the trustee should be permitted to attack by a suit in equity the conveyance of the bankrupt, he shall allege

> and prove by the record of the referee that such procedure has been followed, and that the claims on which he bases his contention have been ascertained and established."
>
> 91 Pac. 455.

The record on these appeals is devoid of evidence of the existence of *any allowed claim* against the bankrupt estate. It does not appear but that the trustee has sufficient property in the estate with which to fully discharge every allowed claim; and, as this court said (Ross Cir. Judge) *In re* Flatland, 169 Fed. 310:

> "Upon the merits, it is plain that resort cannot be had either by court or counsel to anything outside of the record."
>
> 196 Fed. 311.

Bannister's schedule was received in evidence [Tr. p. 156], and he testified [Tr. p. 156], "The schedule of my assets and liabilities which I signed and verified correctly sets forth the various items of indebtedness which I incurred between the 12th of January, 1915, and the 23rd of April, 1915, and the dates when incurred, and those items were all unpaid at the time this schedule was filed, on June 2nd, 1915."

Such evidence (and there was no other) was not proof that any of said creditors had established their claims against the bankrupt estate. At most, it amounted merely to a statement that at the time the schedule was filed there were certain accounts which *Bannister* considered outstanding and unpaid. It was not proof that any of the items were legal obligations of the bankrupt estate, or that the referee had allowed,

or ever would allow, them as approved claims against the bankrupt estate. For all that appears, there might have been any one of a number of reasons why the referee would, and did, refuse to allow all of the alleged debts scheduled. As was said in Crary v. Kurtz, 119 Am. St. 549, 132 Ia. 105:

> *"That outstanding obligations exist is not enough.* Unless these are established and allowed, as authorized by statute or the act of Congress, he [the trustee] has no authority to pay them from moneys that may come in his hands, to say nothing of the property the debtor has transferred to others. * * * Section 57 of the Bankruptcy Act * * * provides for the proof, adjudication and allowance of the claims of creditors, and section 65 * * * directs the declaration of dividends 'on all allowed claims.' Where no claims are allowed, there are no dividends to be paid by the trustee, and therefore no occasion to interfere with property in the hands of third persons. * * * Because of the omission to prove that any claims had been established against the estate, the decree of the district court must be, and is, reversed."
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> 119 Am. St. 555. (Italics ours.)

In order to sustain the burden of proving that the enforcement of the transfers sought to be avoided will operate to the injury of some creditor whom he represents, the Trustee must not only show that claims have been filed and proved against the bankrupt estate, but he must also show the aggregate of such claim and that the amount of the assets of the estate is such that the defendant Bank will, by reason of the transfer sought

to be avoided, receive on its claim a larger percentage than the creditors whom the Trustee represents will thereby receive on their proven claims. In Lesser v. Bradford Realty Co., 95 N. Y. Supp. 933, it was said:

> "It has been directly held that the trustee's right to maintain such an action as this depends upon the fact that he has not sufficient assets in his hands to satisfy the claims of the creditors; the reason for the rule being that, since the transfer is good as between the parties to it, the transaction should not be set aside at the instance or for the benefit of third parties, unless it is necessary that they be heard in the interests of substantial justice. As was said in Mueller v. Bruss (Wis.), 8 Am. Bankr. Rep. 447, 88 N. W. 232:
>
> 'The trustee has no right superior to that of the creditors he represents. If we admit that the facts stated show such transfers to have been fraudulent, still no right to avoid them exists, unless it appears that some one was harmed. It seems quite evident, without argument, that, unless it is made to appear that the property so conveyed is needed to pay the claims filed against the debtor, the trustee has no right to set such conveyances aside.'
>
> Directly to the same effect is the case of Deland v. Miller & Cheney Bank (Iowa), 11 Am. Bankr. Rep. 744, 93 N. W. 304, and I do not find that the rule stated in these cases has ever been questioned."
>
> 95 N. Y. Supp. 933-934.

The record does not disclose the amount of the assets of the bankrupt estate; and there is no evidence as to what property the Trustee actually received or re-

covered, nor its valuation, nor what he realized or could realize thereon out of which to pay allowed claims. In the absence of proof of either the assets or obligations of the bankrupt estate, it was impossible for the court to determine that the creditors, if any, of the bankrupt estate would be injured by the enforcement of the transfers sought to be avoided. Evidence as to what property Bannister claimed to have possessed at or previous to the time he filed his schedule (even if it be some evidence upon the issue of his solvency at those times) was not proof or evidence of the amount of assets that came into the possession of the Trustee, either from the bankrupt or by recovery from third parties; nor was evidence concerning the value of Bannister's property on April 8 and April 23, 1915 (to which dates only was the evidence concerning valuations addressed), either evidence or proof of the value of the assets of the bankrupt estate, or of the amount realized thereon by the Trustee out of which to pay allowed claims; nor evidence or proof of the amount of the assets of the estate at the time the transfers were sought to be avoided, to-wit, when the complaints herein were filed, nor at the time of trial.

The failure of the Trustee to sustain the burden of proving the essential element of a voidable preference to which we have referred should, of itself, resolve these appeals in favor of appellants, irrespective of the other errors assigned; to a consideration of which we will, however, proceed.

II.

The Existence of the Element of "Reasonable Cause to Believe" was Not Established.

Another of the assigned errors common to both appeals was the failure of the Trustee to sustain the burden of proving that the defendant Bank, at the time of the execution, or at the time of the recordation, of the trust deed sought to be avoided in A 32, and at the time of the commission of the alleged preferences sought to be avoided in B 94, had reasonable cause to believe that such transfers would operate to effect preferences in its favor over the other creditors of Bannister of the same class as defendant Bank.

The burden of proof is upon the Trustee to establish the elements of an alleged preference. *In re* Gaylord, 225 Fed. 234, 239-40, it was said:

> "The burden of proof is on the trustee alleging the invalidity or voidability of the transfer. 2 Remington on Bankruptcy (2d Ed.), sec. 1404, p. 1285; Calhoun County Bank v. Cain, 152 Fed. 983, 82 C. C. A. 114, 18 Am. Bankr. Rep. 509. He must prove the insolvency of the debtor, later bankrupt, at the time the security was given. He must establish the existence of other creditors of the same class at that time, and that the enforcement of the security or transfer will operate to give them a lesser percentage of their debt than the secured creditor will receive by reason of his security given by such debtor, and he must also prove the existence of the 'reasonable cause to believe.'"

This element of "reasonable cause to believe" must be established by a fair preponderance of all the evidence in the case, for there is a presumption of fair dealing which will sustain the transfer "if two preferences of substantially equal weight may reasonably be drawn from the proved facts." *In re* Gaylord, *supra,* page 240, it was said:

> "All this must be done by a fair preponderance of all the evidence in the case, and where inferences from proved facts are to be drawn, the rule obtains that if two inferences of substantially equal weight may reasonably be drawn from the proved facts, then that inference shall prevail which sustains the transfer or security."

There is an entire failure of proof of the existence of such "reasonable cause to believe" at any of the times in question, to-wit, April 8, 1915, when the trust deed was received, April 23, 1915, when the trust deed and the mortgages on the automobile and the Wyble warehouse were recorded, or at any time previous to the filing of the petition against Bannister, on May 5, 1915. The evidence as to the alleged insolvency of Bannister, and the asserted knowledge thereof on the part of the defendant Bank, relates only to the period subsequent to April 1, 1915, and is confined to the testimony of Bannister and of Russell, the defendant's cashier. A fair summary of this testimony is as follows:

All dealings between Bannister and the defendant Bank respecting the transactions in question were conducted through Russell, the cashier [Tr. pp. 148, 186]; hence the only information acquired by the defendant

Bank concerning Bannister's financial condition was acquired through Russell; what Russell knew in that regard is to be determined from his testimony as to what he knew and heard, and that of Bannister as to what he told Russell.

Russell testified [Tr. p. 234] he had known Bannister to be one of the best customers of the old Bank of Bakersfield, of which Russell had been cashier [Tr. p. 235]; and when the defendant Bank was organized he solicited Bannister's business, and finally secured him as a customer in November, 1914 [Tr. p. 234.] When the first loan was made it was arranged that their transactions should be carried on in the same manner they had formerly been carried on in the old Bank of Bakersfield [Tr. p. 235], where loans had been made to Bannister, secured by unrecorded chattel mortgages on his stock-in-trade, even before Russell had any connection with that bank [Tr. p. 235]. In short, the arrangement then made, November 2, 1914, and later carried out in their subsequent transactions, was identically the same as that previously pursued by the same parties for a number of years, and found unobjectionable, and which was not known by them to be subject to legal objection [Tr. pp. 245, 246]. Subsequent to November, 1914, Russell became familiar with the condition of Bannister's Bakersfield business, and considered him well fixed financially on April 8, 1915 [Tr. p. 238], and knew that his assets at that time and on April 23, 1915 [Tr. pp. 239-240], consisted of [Tr. pp. 238-9] the Bakersfield warehouse property, which Russell, after investigating its value, considered to be well worth $20,000.00 (the Security Trust Company had a

loan of $14,000.00 on it [Tr. p. 239], and the old Bank of Bakersfield had appraised it at that amount, and its value had increased since then [Tr. p. 249]); two acres at Bannister Siding (including warehouse and private switch, for which Bannister paid $1500.00 [Tr. p. 239]), worth $2000.00; corrugated iron and frame warehouse on leased ground at Wyble Siding, worth $1000.00; twenty acres on San Emidio Ranch, worth $200.00; Stutz automobile, worth $1000.00; hay and grain, mortgaged to defendant Bank for $10,000.00, worth $15,000.00 (Russell was familiar with market value of hay and grain [Tr. p. 235] and aimed to loan Bannister not to exceed seventy-five per cent of its market value [Tr. p. 237]; the market price of it dropped subsequent to April 23 [Tr. p. 250]); and his Hollywood home, which Russell had not seen, but which Bannister told him was worth $12,000.00—a total of $51,200.00, exclusive of his interest in the Los Angeles Hay & Storage Company (the extent of which was unknown to Russell [Tr. p. 240]), and his claim against said company of approximately $17,000.00 (which he told Russell he expected to realize on [Tr. p. 240]). Bannister's liabilities on April 8 and 23, 1915, so far as known to Russell, were [Tr. p. 239] $14,000.00 to Security Trust Company, $10,000.00 to defendant Bank, and that owed various farmers around Bakersfield for hay and grain purchased, not exceeding in the aggregate $4000.00;—a total of $28,000.00.

Nor does Bannister's testimony as to what he told Russell during the period in question respecting his financial condition materially alter the foregoing sum-

mary. There is no evidence that Bannister ever discussed with Russell (nor that Russell knew anything about) any portion of his indebtedness other than that to the Bakersfield creditors above named, and his difficulties with the Los Angeles Hay & Storage Company. The Bakersfield creditors known to Russell have been mentioned; and the record shows the affairs of the Los Angeles concern were mentioned in two conversations between Russell and Bannister as to which Bannister testified. In giving his testimony before the referee and at the trial, Bannister was noticeably uncertain and indefinite, both as to whether he had the second conversation with Russell respecting the affairs of the Los Angeles company previous or subsequent to April 23rd, and as to what was said at those conversations. In testifying before the referee he stated [Tr. p. 130] he returned to Bakersfield immediately after his first interview with the officers of the Los Angeles concern, but didn't know when he next saw Russell and didn't explain to him what had occurred in Los Angeles, and didn't see him on April 23rd, as he (Bannister) was then in Los Angeles. At the trial he stated [Tr. p. 147] the Bank didn't know, prior to April 23rd, of any trouble with the Los Angeles concern, as things had been going satisfactorily subsequent to his trip to Los Angeles, early in April; and [Tr. p. 148] that "sometime in April probably" he told Russell he couldn't get the money on his claim against the Los Angeles company, and was waiving his claim. Later [Tr. p. 164] he stated he had no recollection of talking to Russell on April 23rd, but probably mentioned to him that he

had to go to Los Angeles about the attachment on his house, though he didn't remember. Subsequently he stated [Tr. pp. 183-4] that he first learned the mortgages had been recorded subsequent to their recordation and upon his return from the second meeting at Los Angeles respecting the affairs of the Los Angeles company. It should be noted, however, that both before the Referee [Tr. p. 137] and at the trial [Tr. p. 218] he did state that, whenever it was he had the conversations with Russell, he told him that arrangements to enable the Los Angeles concern to pay its creditors, including Bannister, were proceeding satisfactorily. There is considerable doubt as to whether he ever told Russell of the details of the arrangement respecting the Los Angeles concern [Tr. pp. 140, 142, 240]. The arrangements referred to were [Tr. pp. 181-2] that the Los Angeles concern was to be handled by certain trustees, with Mr. Flory as manager (who was one of the oldest men in the hay business in Los Angeles) and all creditors, including Bannister, were to grant an extension of time in the payment of their claims; which arrangements had received the approval of the most insistent creditors of the company, and were being carried forward when Bannister returned to Bakersfield and had his talk with Russell about it, the forepart of April. The creditors of the Los Angeles concern continued to sign up for the trustee arrangement proposed until within eight or nine hundred dollars of all the claims against the concern had been signed up [Tr. p. 137] and then (April 21, 1915) Wells attached Bannister's Hollywood home and [Tr. p. 163], in response to a letter from

his wife, Bannister went to Los Angeles the next day. It is doubtful whether he mentioned the attachment to Mr. Russell before going to Los Angeles; for he stated at the trial that he didn't recollect whether he did or not [Tr. p. 164]; and Russell stated [Tr. p. 241] that Bannister informed him of the attachment upon his return from Los Angeles, after the mortgages had been placed of record. Bannister further stated [Tr. p. 183] that he was not in Bakersfield the day the mortgages were put of record, but in Los Angeles, and [Tr. p. 184] when he first learned of their recordation they had already been put on record. Upon his return from Los Angeles on this occasion, after the attachment and the failure of the trustee plan of financing the Los Angeles company, and after the recordation of the trust deed and mortgages, he still maintained to Russell [Tr. p. 242] that he was solvent though they were trying to put him in insolvency; and no doubt he honestly thought so; for at that time he did not know he was responsible for a stockholder's liability in the Los Angeles concern, and did not find that out until the petition in involuntary bankruptcy was filed, on May 5 [Tr. pp. 182-3].

Up to the time the mortgages and trust deed were placed of record by Russell, on April 23, 1915, the record shows that, according to the knowledge possessed by Russell of Bannister's affairs, and the information communicated to him by Bannister, Bannister's assets exceeded his liabilities by $23,200.00, exclusive of his claim of $17,000.00 against the Los Angeles concern, at least a portion of which Bannister expected to realize, and had so informed Russell [Tr. pp. 137,

184, 240]. So that, even though Russell had been fully informed of the condition of affairs of the Los Angeles concern, and of Bannister's liability for the debts thereof, his information would still have shown Bannister solvent by a very considerable margin. None of the items of indebtedness scheduled by Bannister [Tr. pp. 156-160], other than those to the Bakersfield creditors already mentioned, were shown to have been known to Russell at any time; in fact, the contrary was the case [Tr. p. 240].

Russell testified [Tr. pp. 240-241] he recorded the trust deed and mortgages on the afternoon of April 23, after the Bank had closed; (the indorsement upon the trust deed and mortgages shows that they were recorded at 4:15 p. m., April 23, 1915 [Tr. pp. 86, 117]). This action was occasioned by his meeting several people on the street in Bakersfield, subsequent to banking hours, who stated they understood Bannister was in financial trouble in Los Angeles. Upon inquiry, he learned that the rumor had been started by one Long, a hay and grain merchant who was a competitor of Bannister; but he did not then know nor then discover the extent of Bannister's interest in the Los Angeles concern, nor the effect, if any, of this trouble upon Bannister's credit at Bakersfield [Tr. p. 241]. Even though he had then known or discovered the exact extent of Bannister's liability in the Los Angeles concern, Bannister would still, according to Russell's information and knowledge, have been solvent by a considerable margin. The only evidence of the condidition of the Los Angeles concern was Bannister's statement [Tr. p. 143] that he thought its liabilities,

including his $17,000.00 claim, exceeded his assets by $28,000.00; in which event Bannister's liability, after deducting his claim (he owning about sixty per cent of its stock [Tr. pp. 135-136]), could not exceed $6600.00, so that, according to Russell's information, he would even then have been far from insolvent.

Such, in substance, was the showing which appellants contend falls far short of sustaining the Trustee's burden of proving in either case the existence on the part of the defendant Bank of the element of "reasonable cause to believe," at any of the times in question; for that element must be established by "a fair preponderance of all the evidence in the case."

III.

The Mortgages of December 21, 1914, and of January 5, 1915, Covering the Wyble Warehouse Building and the Stutz Automobile, Respectively, were Not Void.

Plaintiff contends, and the trial court held [Tr. p. 125] that these mortgages were void as to the Trustee, because they were not recorded within a reasonable time after their execution. Such is not our understanding of the law applicable to the facts under consideration.

Each of these mortgages covered mortgageable property, was given for a valuable present consideration [Tr. pp. 152, 193], and both were recorded April 23, 1915, prior to the bankruptcy proceedings.

It is well settled that the courts of the United States are bound by the construction placed upon state statutes by the highest state court; and this rule is applicable

to the construction of recording acts. In Sturdivant Bank v. Schade, 195 Fed. 188, it was said:

> "On the question whether under the statute of a state an unrecorded deed to real property is valid as against creditors of the grantor, the federal courts in bankruptcy are bound by the decisions of the highest courts of the state."
>
> Syll. 9 p. 190.

In California the recordation of a chattel mortgage is a substitute for the mortgagee's possession thereunder. (Berson v. Nunnan, 63 Cal. 550, 552.) The fact that the mortgages in question were not recorded until April 23, 1915, does not render them absolutely void. They can be avoided *only* by, and in the interest of, those creditors, if any, of Bannister who became such between the execution and the recordation of the mortgages; and when the trustee in bankruptcy of the mortgagor seeks to avoid them he must show that he represents creditors whose claims have arisen intermediate the execution and recordation of the mortgages, and that those claims have been established against the bankrupt estate. Such we understand to be the law of California.

In Ruggles v. Cannedy, 127 Cal. 290, the supreme court of California held a chattel mortgage not recorded within a reasonable time after its execution void as to those creditors of the mortgagor who became such between the execution and the recordation of the mortgage, and who had established their claims by having them proved and allowed in the insolvency court. In a strong dissenting opinion in that case Jus-

tice Garoutte clearly shows that such a mortgage is not void as to creditors existing at the time of its execution.

> "Yet it is not even claimed here that this mortgage is void as to creditors existing at the time it was executed, and no such claim can be made, for then the whole superstructure of the court's reasoning, builded story after story upon the theory of the creation of a false credit in the mortgagor and a public policy opposed to secret liens, would come down with a crash; for, as to creditors in existence prior to the execution of the mortgage, there would be no false credit in the mortgagor and no secret lien in existence at the time their debts were created."
>
> 127 Cal. 310.

And later, in the case of Summerville v. Kelliher, 144 Cal. 155, the supreme court held that such a mortgage was not void either as to creditors existing at the time of its execution nor as to creditors who became such subsequent to its recordation. An examination of the opinion in Summerville v. Stockton Milling Co., 142 Cal. 529, referred to in the opinion in Summerville v. Kelliher, *supra;* discloses that the judgment upon which the execution sale referred to in Summerville v. Kelliher was made, was obtained on November 1, 1897, and was assigned to Summerville, so that the indebtedness sued on was necessarily incurred prior to October 16th, 1899, the date of the execution of the mortgage sought to be avoided in Summerville v. Kelliher, which mortgage was held valid both as to Hersom, the trustee in bankruptcy of the mortgagor, who was appointed subsequent to the recordation of the mortgage, and as

to Summerville, the prior creditor. In Summerville v. Kelliher, *supra,* the California supreme court, in refering to Ruggles v. Cannedy, *supra,* said:

> "The mortgage was not void from the delay of fifteen days in recording it. No rights were acquired, nor was any prejudice suffered by either Summerville or Hersom during the interval between the date of execution and the date of recording. Ruggles v. Cannedy, 127 Cal. 290, has no application. In that case there was a delay of more than six months in recording the chattel mortgage. In the meantime credit had been extended to the mortgagor, and it was against the creditors thus misled that the mortgage was declared void because of the delay. No such conditions appear here."
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> 144 Cal. 157.

The authorities just cited, and the quotation hereinbelow made from the opinion in Ruggles v. Cannedy, *supra,* show that the mortgages in question here can be avoided only by, and in favor of, those creditors, if any, whose claims arose intermediate the execution and recordation of the mortgages, and who have established their claims against the mortgagor by judgment, attachment, or otherwise. (Ruggles v. Cannedy, 127 Cal. 290. Italics ours):

> "This action is brought by the assignee in insolvency of one Wilgus, seeking a decree declaring void against creditors a chattel mortgage executed by Wilgus to defendant Cannedy. * * * *Intermediate the time of giving and the time of recording the mortgage Wilgus incurred debts,* some of which *were proved and allowed in the insolvency court.* The creditors knew nothing of

the mortgage until its recordation. The court, at the suit of the assignee, under the facts adjudged the mortgage to be null and void *as to these creditors.* * * * But this, it is to be noted, does not mean that such a mortgage between the parties, and as to all the world, is absolutely void, like an unrecorded builder's contract under the mechanic's lien law. It does mean, however, that it may be avoided at the instance of anyone in the enumerated classes—creditor, purchaser, or incumbrancer—*whose right accrues during the time the recordation is withheld.* Between the parties, the unrecorded mortgage is, of course, valid. It is likewise valid against any creditor, purchaser, or incumbrancer whose claim arises after recordation. * * * Of course, it is true in general that *a creditor at large of the mortgagor cannot set aside a mortgage for lack of recordation,* any more than can such a creditor set aside a sale void for want of immediate delivery. *He must come first with his judgment-lien, execution levy, attachment, or some other process or right by which he has acquired a specific interest in or claim upon the particular property.* But since, as has been discussed, he may acquire this lien or right after recordation, and since, when acquired, the mortgage is void as to him, it makes little difference whether it be stated as the rule that the law requires immediate recordation, or whether it be said that, while it does not require immediate recordation, the mortgage is void as to creditors *who have become such during the time recordation has been delayed.* It is but a change in the form of words, while all of the legal effects remain the same. * * * Or, taking it in the other view which has been presented, even if it be said

> that the law does not require immediate recordation, still the mortgage is void as to those who during the time that the mortgage has been withheld from the records have given credit to the mortgagor, and it is *in favor of these that the mortgage has been set aside.*"
>
> 127 Cal. 293-306.

The situation presented by the facts in Ruggles v. Cannedy is not that presented by the record on these appeals. As the Trustee failed to show that any of the creditors scheduled by Bannister had proven their claims before the Referee, he necessarily failed to show that any creditor whose claim accrued intermediate the execution and recordation of the mortgages in question had done so.

Since a chattel mortgage not recorded within a reasonable time after its execution is, under the law of California, void only as to those creditors whose claims have arisen intermediate the execution and recordation of the mortgage, reason dictates, and the authorities hold, that, in an action to avoid such a mortgage, prosecuted by the trustee in bankruptcy of the mortgagor, the Trustee must show that he represents such creditors, and that their claims have been allowed in the bankruptcy court. To this effect is the decision of this court *In re* Flatland (per Ross, Cir. Judge, 1912), 196 Fed 310, where the trustee contended that because, by reason of the amendment of 1910 to section 47a of the Bankruptcy Act, he had in such action all the rights of a creditor possessing a levy upon the property in controversy, the lien of a chattel mortgage would not be valid against him if for any reason it

be invalid as against a claim of a levying creditor. This contention the court answered, dismissing his petition for a revision of an order sustaining the chattel mortgage in question, because the record did not show that the trustee represented any creditor as to whom the mortgage was void; the court saying (page 312):

> "A conclusive answer to the suggestion here made is that there is nothing in the record showing that any of the creditors of the bankrupt other than the respondent held any lien of any character."

Similarly, in the case at bar the contention of the Trustee that the mortgages in question are void as to him because not recorded within a reasonable time after their execution, is conclusively answered by the fact that there is nothing in the record showing that he represents any creditor as to whom the mortgages in question are void; such creditors (as the supreme court of California has held in the cases cited *supra*) being only those whose claims arose while the mortgages were withheld from the record, and whose claims were proved and allowed in the bankruptcy court. To the same effect is the decision in Sparks v. Weatherly, 176 Ala. 324, 58 So. Rep. 280, where the court construed the amendment of 1910 to section 47a, and it was stated:

> "A trustee in bankruptcy who sues in a state court to reach land sold by the bankrupt prior to the adjudication in bankruptcy, on the ground that the conveyance is void under Code 1907, section 3383, providing that conveyances are void as to judgment creditors without notice, unless

recorded before the accrual of the right of such judgment creditors, must show that he has or represents a judgment creditor with a lien and without notice."

Syll. 1, 58 So. 280.

Also *In re* Stern (Ohio, 208 Fed. 488), where, after quoting from the amendment of 1910 to section 47a, the court says:

"Our view of this latter provision is that the trustee represents the several creditors, under this language, with varying powers and opportunities, appropriate to the different status of the several creditors. He is, with respect to each of the five creditors holding accounts for merchandise going into the stock and becoming part of the stock of goods, in the position of a creditor holding a judgment rendered for the purchase price and, with respect to the several other creditors, a judgment creditor with the limitations inherent in the nature of their several claims."

208 Fed. 490.

IV.

The Various Chattel Mortgages Upon Bannister's Stock In-Trade were Not Void, but Constituted Equitable Liens in Favor of Defendant Bank Superior to the Trustee's Title.

The chattel mortgages, both recorded and unrecorded (other than those covering the Wyble warehouse building and the Stutz automobile, which have been considered elsewhere), were received by defendant Bank under the following circumstances:

During the period of time in question Bannister was purchasing hay and grain from the farmers around Bakersfield, and needed funds to advance them to aid them in harvesting their crops, and later to pay them the balance of the purchase price [Tr. pp. 151, 152, 153, 154]. He, therefore, applied to the defendant Bank for loans from time to time for that purpose, stating to Russell, the cashier, at the time he applied for the loans, why he desired the funds, and that he would mortgage to the Bank as security therefor the property purchased by the loans [Tr. pp. 187, 189, 191, 192]. Upon that understanding the loan in each instance was made, the property purchased with the loan, and, as a part of the same transaction, was mortgaged to the defendant Bank. In the instances where the property had not been moved to Bannister's warehouse at the date of the loan, it was agreed at the time the loan in question was made that as soon as the property was removed to the warehouse a blanket mortgage would be given on all of it, which was done on January 12, 1915, pursuant to the previous conversation to that effect [Tr. pp. 188, 237]. In some instances Russell went out and looked at the grain before making the loan [Tr. pp. 190, 236], and in other instances he was already familiar with it [Tr. p. 236]; and when the blanket mortgage of January 12 was taken, he went down to the warehouse with Bannister, and checked over the property described in the mortgage, and identified it [Tr. p. 237, 238]. At the time each of these loans was made Bannister did not have funds with which to make the purchase in question other than by securing these, or similar, loans [Tr. pp. 189, 191,

192]. Subsequent to the giving of the blanket mortgage on January 12, and prior to April 23, shipments may have been made out of the mortgaged property [Tr. pp. 195, 196], but were immediately replaced by other similar property of the same amount [Tr. pp. 194-5, 200-201], and the proceeds of any of such sales, less the expenses incident thereto, were paid to the Bank and applied on his indebtedness [Tr. p. 201]. In other words, the mortgages were in the nature of purchase money mortgages, because the property in controversy would never have become Bannister's property at all had it not been for the money advanced to him by the defendant Bank, which was advanced in reliance upon his agreement to mortgage the property purchased by those funds, as security for the loans, and that agreement was carried out, so far as it was practicable for the parties to do so; the property in question being identified in detail in the various mortgages, and particularly in that of January 12; and at the time that mortgage was given the property described was checked over and identified by the parties as being then in the warehouse. And thereafter no sales were made out of the mortgaged property but what were replaced by other similar property of a like amount; and the proceeds of any of those sales, less the expenses incident thereto, were applied on Bannister's indebtedness to the defendant Bank.

Under such circumstances the equities of the situation are clearly all in favor of the defendant Bank, for the Trustee is attempting to recover property, or the proceeds thereof, which was acquired, and only could have been acquired, by Bannister by reason of

the defendant Bank's loans; hence, so far as the creditors, if any, whom the Trustee may represent (other than those who extended Bannister credit intermediate the execution and recordation of the mortgages) are concerned, they are in no worse position by reason of the enforcement of these mortgages as valid equitable liens than they would have been had the transactions in question never occurred; and as to the existence of creditors with proven claims, whose claims arose intermediate the giving and recordation of these mortgages, the record on these appeals is silent, as has been heretofore shown.

A distinction, made by the decisions, should be noted between the case where the property sought to be mortgaged is the *very product* of the advances sought to be secured thereby, and that where it is not. In the first case (as in B 94) an equitable lien is created (though the mortgage may be void as a statutory mortgage for noncompliance with the statute), which is good, irrespective of possession taken by the mortgagee, against all but bona fide purchasers for value and without notice and those creditors only who can show that they made advances relying upon the property being unincumbered. Examples are: Hurley v. Atchison etc. Ry. Co. (213 U. S. 126), where the railroad company had made an advance payment for coal to be mined in the future, to enable the coal company to pay for the labor of mining the coal; and the court held the advances to be a pledge of the coal, and that the trustee in bankruptcy took the mine subject to the obligation to deliver the coal as mined, to the extent

of the advances; and this irrespective of possession by the railroad company; the court saying (page 132):

> "It is settled that a trustee in bankruptcy has no equities greater than those of the bankrupt, and that he will be ordered to do full justice, even in some cases where the circumstances would give rise to no legal right, and, perhaps, not even to a right which could be enforced in a court of equity as against an ordinary litigant. Williams' Law of Bankruptcy (7th Ed.) 191. Indeed, bankruptcy proceeds on equitable principles so broad that it will order a repayment when such principles require it, notwithstanding the court or the trustee may have received the fund without such compulsion or protest as is ordinarily required for recovery in the courts either of common law or chancery."

In re Flatland, *supra,* where this court, quoting from the foregoing decision of the United States Supreme Court, held a chattel mortgage on a stock of goods and fixtures of a merchant, which were the product of the money sought to be thereby secured, to be valid against the trustee without the mortgagee having taken possession previous to bankruptcy. In the same class is the case at bar (B 94), where the property sought to be mortgaged was the product of the money sought to be thereby secured, and was by the parties intended to be so secured. *In re* Grainger (160 Fed. 69, per Ross, Cir. Judge) this court went even further in sustaining as against the trustee a chattel mortgage upon property which was not the product of the money sought to be thereby secured and where the mortgage was void as a statutory mortgage (covering property

not permitted by statute to be mortgaged), and possession was not attempted to be taken by the mortgagee.

In such cases as those instanced the court is loath to permit the intentions of the parties (honestly expressed at the time of the transaction in question) to be defeated by a trustee in the interests of general creditors who have not been injured by the transaction or who have not been as diligent as the defendant in protecting their claims, and particularly where the property sought to be mortgaged is the product of the money advanced by the defendant, which would not otherwise have been advanced. As was stated *In re* Automobile Livery Service Co., 176 Fed. 792 (Ala. 1910):

> "There is always a strong equity in favor of a lien by one who advances money upon the property which is the product of the money so advanced. This was what the parties intended at the time, and to this, as already stated, there is and can be no objection in law or in morals."
>
> (Quoting Sabin v. Camp, 98 Fed. 974.)
>
> 176 Fed. 795.

In re Chantler, 151 Fed. 952, the court said:

> "* * * as a court of bankruptcy acts upon principles of equity, it must be held, *irrespective of whether the mortgagee took possession under the mortgage,* that an equitable lien arose in favor of the mortgagee upon the after-acquired property, which was for a present consideration and therefore not invalid as to creditors, and that the lien of the mortgage attaches to the proceeds of the sale of after-acquired property as well as to the proceeds of property in the bankrupt's possession at the date of the mortgage."
>
> 151 Fed. 953.

The mortgages in question are unquestionably good as equitable liens as against Bannister and all creditors except those who made advances subsequent to the execution of the mortgages in question, and prior to the taking of possession thereunder by the defendant Bank, or the intervention of bankruptcy, and creditors who, prior to bankruptcy, actually fastened on the particular property by attachment or execution; and the mortgages may be good even as to the latter class, for it has been held (Pac. Bank v. Coats, 205 Fed. 618, 626; Love v. S. N. etc. Co., 32 Cal. 639, 653) that an attaching or execution creditor's lien is subject to a prior equitable lien since an attachment or execution reaches only the actual and not the apparent interest of the debtor. As has been observed, the record is silent as to the existence of the former class of creditors; and as to the latter, it affirmatively appears [Tr. p. 186] that when bankruptcy intervened no creditor, other than defendant, had fastened on the property in question, and no action was pending, and no judgment had been secured against Bannister, and no attachment had issued against him other than that of Wells, who had attached his Hollywood home [Tr. p. 165], which is not the subject of controversy in these appeals.

The trial court decided [Tr. p. 126] that the defendant Bank did not have an equitable lien upon the property in question, for the supposed reasons that the property was not capable of being mortgaged, that the defendant did not go into possession of the goods prior to the intervention of bankruptcy, and that there was a substitution of the mortgaged goods. The decision of the learned trial court in the premises is

contrary to the decision of this court in the Grainger case (*supra*), where the mortgage in question was held valid as an equitable lien as against the general creditors, represented by the Trustee, in spite of the existence of the very circumstances upon which the trial court in this case (B 94) based its decision. In the Grainger case the mortgage in question was invalid as a statutory mortgage, because it was given upon property which the code did not permit to be mortgaged, including the stock-in-trade of the mortgagor. Such is the situation in the case at bar. In the Grainger case no attempt was made by the mortgagee to take possession of the property prior to the intervention of bankruptcy proceedings, and the property all came into the possession of the Trustee and was by it sold; whereas in the case at bar the defendant Bank did attempt, prior to the intervention of bankruptcy proceedings, to take possession of the mortgaged property (and, as defendant contended at the trial, succeeded in so doing), and disposed of all the property under authority given in the mortgages in question. In the Grainger case the mortgage in question was given on June 1, 1906, and the mortgagor continued to do business until the 9th of August, during which time there was necessarily a substitution and confusion of goods, so far as his stock-in-trade was concerned which was covered by the mortgage in question; and there does not appear to have been any attempt to segregate the property intended to be mortgaged, nor to maintain the bulk and character of the mortgaged property, which, however, was done in the case at bar.

In the Flatland case *(supra)* the effect, upon a transaction giving rise to an equitable lien, of the amendment of 1910 to section 47a of the Bankruptcy Act was considered and decided adversely to the Trustee's contention; and the decision in the Grainger case *(supra)* has not been affected by that amendment; for that amendment has not altered the law of California respecting either the character of chattels that may be mortgaged, or the necessity for the recordation of such a mortgage, or the necessity for the mortgagee to take possession thereunder, or the rights of the various classes of creditors as affected by the existence of an equitable lien or by a failure to comply with the recording statutes. That amendment simply gives the Trustee the rights of the creditors he represents, leaving it to the particular state to determine what those rights may be; and the Trustee cannot recover herein for he has not proved that he represents creditors as to whom the transfers in question are void under the law of California.

V.

Defendant's Objections to the Amendment to the Bill in B 94 Should have been Sustained.

The amendment in question in substance alleged [Tr. p. 91] that at the time Bannister was adjudged bankrupt he had various creditors other than defendant, many of whom held unsecured claims, certain of which were incurred between January 12 and April 23, 1915, and certain of which were incurred prior to January 12. The objections to said amendment were taken by

way of answer thereto and to the bill as thus amended [Tr. pp. 87-88], on account of the fact that the allegations of said amendment were mere conclusions, and because of certain specified uncertainties thereof, to-wit, that the amendment did not disclose what creditors Bannister had on May 24, or the class of said creditors, if any, or the amounts of their respective claims, if any, or when said claims, if any, were incurred, respectively.

These objections were filed April 4, 1916, and plaintiff did not amend so as to meet those objections prior to the trial (which began May 23) or at all; and during the trial defendant objected [Tr. p. 155] to the introduction of any evidence in support of said amendment; which objections the court overruled.

That the allegations of the amendment objected to are mere conclusions is apparent from their reading [Tr. p. 91]. Further, it was not alleged that the indebtedness referred to was reduced to the form of allowed claims, which, as has been elsewhere shown, was essential. As the mortgages in question, if void, were void (as has elsewhere been shown) only as to those creditors whose rights accrued intermediate the execution and recordation of said mortgages, or intermediate the execution of said mortgages and the intervention of bankruptcy proceedings, and only as to those creditors providing their claims had been established against the bankrupt estate by the allowance of the Referee, the defendant was clearly entitled to know (and hence necessarily prejudiced by the failure of the Trustee to either allege or prove) what creditors the Trustee claimed to represent, and as to whom

he claimed the conveyances in question to be void, and the circumstances under which those claims, respectively, were incurred, and the amounts thereof.

Teague v. Anderson Hardware Co., 161 Fed. 765:

"It is impossible to determine satisfactorily whether the lien of this mortgage was effective and operative before its record, under the law of Alabama or under the general law so far as applicable, without knowing the dates when the debts of general creditors other than the Anderson Hardware Company were created, and probably, also, the character and amount of the debts. The allegation in the bill on this subject is as follows:

" 'Orator further shows that a large part of the indebtedness of said Street to creditors who have proven their said claims was created subsequent to the date of said mortgage, and all of said indebtedness was created prior to the filing of said mortgage for record.'

"On this question, under all the authorities, the rights, if any, of general creditors, as against the holder of an unrecorded mortgage, which would be good against the mortgagor, are different in this respect. Debts created after the mortgage was given, and upon the faith of the mortgagor's property being unincumbered, have greater rights than debts in existence at the time the mortgage was made. I think the defendant is entitled to have, and also the court, that it may intelligently pass upon the questions involved, as a part of this bill, the names of all creditors of the bankrupt other than the Anderson Hardware Company, the amounts of their debts, the character of same, and when created.

> "As this ground of demurrer is good, it is unnecessary to pass upon the other questions in the case until this defect is cured. If the complainant desires to amend in this respect, he may do so in 20 days from this date, and on failure to do so the demurrer on the ground stated will be sustained, and the bill dismissed."
>
> 161 Fed. 766.

The amendment objected to obviously does not (nor does the bill of complaint) allege that the Trustee represented creditors who had established their claims against the bankrupt estate, as required by the bankruptcy law; nor does either the bill or the amendment allege facts indicating that the claims of the creditors, if any, represented by the Trustee were created under such circumstances as to render the mortgages sought to be avoided void as to them. Such only could have been the purpose of the amendment in question; and that it was incumbent upon the Trustee herein to make such proof we have already shown. In the Flatland case, *supra,* a case similar to that at bar, this court dismissed the petition of the Trustee because (196 Fed. 312) he failed to show that he represented creditors as to whom the conveyance sought to be avoided was void.

VI.

Evidence in Support of the Amendment to the Bill in B 94 Should have been Excluded.

The trial court, over defendant's objection, permitted Bannister to testify [Tr. p. 156]:

"The schedule of my assets and liabilities which I signed and verified correctly sets forth the various items of indebtedness which I incurred between the 12th of January and the 23rd of April, 1915, and the dates when incurred; and those items were all unpaid at the time this schedule was filed, on June 2nd, 1915."

Such testimony was not within any issue presented by the pleadings; for, as has just been indicated, there was no allegation in the original bill, nor in the amendment thereto, sufficient to raise the issue as to the names and amounts of claims incurred between January 12, 1915, and April 23, 1915, and the dates when incurred. Furthermore, until it was alleged and proven that the items sought to be established by this testimony had been by the respective claimants established against the bankrupt estate in the manner provided by law, the statement of Bannister as to when the items were incurred was not material.

By reason of the Trustee's failure to prove:

(1) A deficiency of assets of the bankrupt estate to satisfy proven claims.

(2) The existence of the element of "reasonable cause" to believe that the enforcement of the transfers

sought to be avoided would operate to effect preferences.

(3) That he represents creditors as to whom the conveyances and transactions in question are void under the law of California. And

(4) Because the defendant Bank acquired, by the transactions through which said mortgages were received, an equitable lien upon the property covered by the chattel mortgages set forth in the pleadings in B 94; it is respectfully submitted that the decrees in both A 32 and B 94 should be reversed, with costs to appellants.

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